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RUEHBJ/AMEMBASSY BEIJING 0764
RUEHBY/AMEMBASSY CANBERRA 0633
RUEHLO/AMEMBASSY LONDON 1456
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UNCLAS SECTION 01 OF 04 PRETORIA 000565

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TAGS: EMIN EPET ENRG EINV EIND ETRD ELAB SF
SUBJECT: Gold's Glitter is Fading in South Africa

REF: 07 Johannesburg 0214

¶1. (SBU) SUMMARY: The South African gold mining industry has not been able to fully capitalize on record gold prices during 2007-2008. Gold mining was disrupted by a number of events, which have cost millions of dollars in lost production and export revenues. First, a power crisis came to a head when gold mines (and most of the rest of the mining industry) were shut down for almost a week in January 2008 when a number of Eskom's power plants went off-line and power output fell to less than 75 percent of capacity. Eskom first restricted supply to mines to 90 percent of historical demand when power was restored, but has since agreed to increase this to 95 percent on a case by case basis because of potential impact on mine closures and job and export revenue losses. Second, safety issues caused the Department of Minerals and Energy to close some mines for up to a week during fourth quarter 2007 in response to a spate of fatal accidents, fueling limited strikes focused on safety. Finally, declining ore grades and rising costs have also contributed to declining production in some mines. China overtook South Africa as the world's number one producer in 2007 and is likely to retain this position. South Africa will likely continue its decline in production in 2008. End Summary.

¶2. (U) Energy Officer and Specialist met with the CEO's of South Africa's three largest gold mining companies and mining research organizations, attended Africa's premier Mining Indaba, and descended into one of South Africa's "cutting edge" deep mines early in 2008 in order to prepare this cable.

¶3. (SBU) BACKGROUND: The Witwatersrand sedimentary gold basin was discovered in South Africa's north-central region in 1886 and has proved to be the world's biggest and richest gold deposit, supplying almost one-half of the world's gold ever produced. Initial mining was carried out on small scale outcrops around Johannesburg, and then mining consolidated and went deeper as easy-to-recover gold from the shallow oxide zone was depleted. Some 70 individual mines were listed on the Johannesburg Securities Exchange (JSE) in the 1970's, but this was reduced to less than 10 by the early 2000's. Currently, mining takes place from surface outcrops to 4,200 meters below surface and South African gold mines are discounted on international stock exchanges because of depth, cost, safety and political risk. Gold accounts for about 1.5 percent of South

Africa's GDP, 18 percent of total minerals produced, and 20 percent of mineral exports (9 percent of merchandised exports).

¶4. (SBU) South Africa has missed out on much of the current commodities boom (reftel), partly because of the normal time-lag between new demand and gearing up to deliver new supply. This has been exacerbated by uncertainty in the implementation of the SAG's new minerals policies and legislation. Lack of experience and capacity within the Department of Minerals and Energy (DME) has caused the re-licensing process to take a long time and some companies have resorted to the courts to get their permits approved.
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Uncertainty has inhibited potential investment in new mines and mine expansions, particularly in exploration. By the end of 2006, investors seemed to have overcome some of their concerns. Gold mining investment increased rapidly during 2007 and major new projects were announced. This positive development was short-lived as the gold mining industry ran into a number of additional obstacles during late 2007 and early 2008. These obstacles include a power crunch, safety challenges, and declining ore-bodies in the face of rising costs.

Grappling with the Energy Crunch

¶5. (SBU) Major gold mines in South Africa were shut down between January 25 and 31 when state power company Eskom announced that it could no longer guarantee power for production or the health and safety of workers. The estimated production losses for the gold mines exceeded $30 million per day. Eskom warned that it would take four to five years before significant new capacity comes on line to balance supply and demand. Heavy power users agreed to a 10 percent power reduction for the foreseeable future to prevent a total system

failure, but at a substantial cost to output and employment. DME and Eskom subsequently agreed to lift power supply to 95 percent of mine requirements in response to industry warnings that 90 percent power supply would lead to shaft closures and lay-offs. The new allotment will be phased in as soon as possible, and Eskom intends to monitor the effect on the system. Eskom has warned consumers that system instability and insufficient conservation measures could force resumption of load-shedding, applied sparingly since the occurrence of substantial power outages in January.

¶6. (SBU) The mining industry is not happy about power rationing and continues to harp on negative impact on jobs. However, biggest producers AngloGold Ashanti, Harmony, and DRDGold said they could implement efficiency measures to cope with a 90 percent supply, so the increase to 95 percent should ensure nearly full production. Anglo has stated they planned to reduce power consumption by 15 to 17 percent over the next few years. At the 90 percent level, Harmony announced that it would have to close some shafts, redeploy some 5,000 workers to other operations, and force a similar number to take early retirement. Second biggest South African gold producer Gold Fields complained bitterly about the 10 percent power cut. CEO Ian Cockerill said the company intended to close a number of less profitable shafts and sections, which would "initially" result in some 7,000 retrenchments. He reasoned that 50 percent of the power dedicated to Gold Fields' 3,000 to 4,000-meter deep mines was required just to maintain essential services such as pumping, ventilation, and cooling, so a 10 percent cut in power was equivalent to at least a 20 percent loss of production. Cockerill also asserted that retrenchments could escalate to 20,000 if production costs continue to increase by 20 percent per annum. This could affect the livelihood of some 200,000 people, so this encouraged the union-backed ANC government to review the level of power rationing.

Wrestling with Safety Challenges

¶7. (SBU) Mining companies have applied increasing attention to worker safety and fatality and accident rates have shown a general

decline over past decades, but the 2007 count was the highest in six years: 212 deaths up from 199 in 2006. The tripartite (labor, government and industry) Mine Health and Safety Council reported that about 56 percent of fatalities and 30 percent of all serious injuries occurred in gold mines, most of which qualify as deep-level mines. The South African Mines Reportable Accidents Statistical System showed the main causes of fatalities to be rockfalls, followed by rockbursts, locomotive accidents, and falling material. Many rockfalls relate to seismic events caused by deep mining and these made up about 63 percent of all gold-mining fatalities. The Council says it has spent close to $25 million since 1994 in order to tackle the problems of rockfalls and seismic events. A recent study on human factors in accidents points to cultural and
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attitudinal criteria as playing a major role in some 72 percent of all accidents.

¶8. (SBU) The issue of mine safety was highlighted in the local media when Anglo American's new Canadian CEO Cynthia Carroll removed senior executives on the basis of their inattention and poor performance on health and safety. The issue was given further focus when 3,200 miners were trapped 3,000 meters underground at Harmony's Elandsrand gold mine for more than 24 hours on October 2-3, 2007. No fatalities or injuries were recorded, but the incident damaged the safety reputation of South Africa's gold mining industry and commanded a response from all players. (COMMENT: The only good thing about the event was that it forced dozens of illegal miners to the surface, where they were promptly arrested. End Comment.) The National Union of Mineworkers accused the mines of practicing "genocide" against workers and staged a one-day strike to protest unsafe working conditions. The DME reacted by closing entire shafts and mines after fatal accidents (instead of only the particular working area) and has mooted charging managers with criminal liability where insufficient safety practices exist. President Mbeki ordered the Minister of Minerals and Energy to conduct safety audits on all the country's mines during 2008. The DME inspectorate does not have sufficient capacity for the task and is being assisted

by industry.

¶9. (SBU) Mining representatives argue that it is counter-productive to close the entire mine after a fatality and that by doing so the DME is exceeding the requirements of its own legislation. Moreover, they assert that such closures exacerbate rather than improve safety conditions and that deep mines require continuous attention at working faces to maintain safe roof conditions and to forestall dangerous rockbursts. However, government remains determined to put an end to safety violations where they are found to exist.

¶10. (SBU) Gold mining companies agree that the government's strong reaction serves to focus attention on mine safety issues and can encourage stakeholders to work together. They believe, however, that the causes of accidents include skills shortages and a workforce where as many as 50 percent have no previous mining (or industrial) experience. Depth of mining is not considered a safety issue if properly managed. There is a critical need to increase safety training and awareness among managers and workers in order to change cultural attitudes toward safety.

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Resisting Declining Ore Grades and Rising Costs
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¶11. (SBU) South Africa has been the world's major gold producer since 1905 when it overtook the U.S., reaching a peak output of 1,000 tons in 1970. Production declined by another 7.4 percent in 2007 to 254.7 tons, and estimates predict a further 10 percent decline in 2008 due to power shortages. At the same time, Chinese output increased to between 270 and 276 tons in 2007, garnering them the rank of world's number one producer, as acknowledged recently by the South African Chamber of Mines. Gold's contribution to the economy has declined and the size of its revenues has been overtaken by platinum, coal and the ferro-alloy industry (see table below). Nevertheless, gold mining remains important as an employer of unskilled labor and a generator of foreign exchange. South Africa

maintains the potential to add over one million extra ounces (32 tons) to annual output if planned production from new mines and expansion projects comes on line over the next three to five years, assuming that costs, safety and electricity disruptions are contained, and that the gold price continues its upward march past $1,000 per ounce.

¶12. (SBU) Seismic surveys indicate that gold reefs extend nine kilometers below the surface in many areas of the 65,000 square kilometers gold-bearing Witwatersrand basin. Major mining houses have committed to significant mine expansions in 2006-7, a number going deeper than four kilometers. As mines go deeper, operating costs will increase for ore-body access and worker transportation, rock hoisting, health and safety, ventilation and cooling, and pumping. Some of these expansions may be delayed or indefinitely postponed should power shortages remain in place for an extended period. Regulatory and licensing uncertainty also remains a major impediment to investment and production commitments.
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¶13. (SBU) COMMENT: Gold production is expected to decline further in 2008 due to challenges associated with power shortages, safety issues, and declining ore grades in the face of rising costs. The South African gold industry will remain a significant employer and export earner, even if its place in the economy and the minerals sector gradually declines. Government will need to work collaboratively with labor and industry in order to lessen the rate of decline and take advantage of remaining harder-to-reach geological potential. Otherwise, the South African gold industry will continue to lose its glitter. End Comment.

¶14. (U) Appended tables below show:
-- Decline in actual employment of South African gold mines and as a percentage of the industry as a whole
-- Increase in employment on non-gold South African mines, particularly since 1995-2000
-- Decline in actual South African gold production and as a percentage of global production
-- Increase in the value of sales of non-gold commodities compared to gold and gold's declining share of total sales

Employment (1000's)	1985	1995	2000	2005	2006	2007	%Change
All Mines	807	599	418	444	459	500	-38
Gold Mines	528	380	217	161	160	160	-70
Non-Gold Mines	279	219	201	283	299	340	+22
%Employed by Gold Mines	65	63	52	36	35	32	-51

Gold Production (tons)							
SA	673	524	431	295	272	255	-62
SA as % of Global	44	23	17	12	11	10	-77

Sales Value (R billions)							
All Mines	27.2	55.1	98.5	143.4	195.5	223.0	+720
Gold Mines	15.3	23.5	25.2	24.6	37.4	38.2	+150
Gold as % of Sales	56	43	26	17	19	17	-69

BOST